eligible. The Court of Appeals vacated that decision, finding that the Commission had not adequately explained its actions.[39] Its decision pointed out that the Commission's price cap rules apply to "[a]ny tariff filing involving a service that is within a price cap basket," and that this necessarily included promotional rate reductions.[40] The Court thus held that if the Commission intends to change its price cap rules and deny credit for promotions, "it must offer a reasoned explanation of why promotional rates should be treated differently from other rates."[41]

Despite this clear and unambiguous directive, the Further Notice never clearly articulates the basis upon which it proposes to deny price cap credits for APPs.[42] However, review of the Further Notice indicates

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[39] AT&T v. FCC, 974 F.2d 1351 (D.C. Cir. 1992).

[40] Id. at 1355.

[41] Id.

[42] The record in the Commission's earlier Notice in Docket 87-313 also does not support any differences between promotional tariff offerings and other price reductions that could rationally justify a difference in the price cap index credit for these filings. See AT&T's Comments, filed July 6, 1993 in CC Docket No. 87-313 at pp. 10-12. Contrary to the concerns expressed in the earlier Notice (8 FCC Rcd. at 3716), allowing index credit for APPs would not confer any greater latitude to increase other rates within the same basket than AT&T already has because, by design, any price reduction for one service always permits a corresponding increase in rates for other services. AT&T Comments at 10. Nor is there any basis for

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an apparent concern on the Commission's part that AT&T may somehow have an unfair competitive advantage in offering promotions because it could recoup the revenue lost by a promotional offering by raising "general schedule rates without the fear of losing customers to a competitor." (Id. at ¶ 13 and n.47). AT&T has shown in its Reclassification Motion and in Point I above that this is simply not so. There is no "captive" customer base whose rates may be raised with impunity. On the contrary, residential customers, regardless of usage levels, have been changing carriers at a record pace, with 30 million changes projected during 1995 alone. Indeed, residential customers with less than $10 per month in average usage (about whom the Further Notice appears most concerned), have accounted for about 40 per cent of the recent churn. Hence, basic service customers can and do respond to rate changes and AT&T has no ability to raise general schedule rates without regard to competitive market forces.

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concern as to supposed "cross-subsidization," because promotional tariffs are subject to the same basket and service category structure and the same cap and band limitations that apply to other price cap filings. Id. at 11-12. AT&T's Comments (pp. 14-17) also showed that promotional tariffs had benefited all customers by stimulating usage of its services, thereby generating additional minutes of use that produce greater network efficiencies.

It also appears from the Further Notice (¶¶ 28-51, 57) that this proposal may have been prompted by the concern that AT&T could exaggerate its demand forecasts for APPs, thereby creating extra headroom for basic rate increases. There is, however, no support in the record that AT&T has ever erred in its demand forecasts for promotions in the manner hypothesized in the Further Notice. On the contrary, AT&T's tariff filings during the most recent full year (1994) have consistently understated demand for promotional offerings. Specifically, since 1994 AT&T has provided the Commission a summary and tracking report for promotions that have created headroom under the price cap rules. This report tracks the actual results, compared to demand forecasts, for promotions that are projected to generate over $10 million in annualized headroom. Actual demand has exceeded projected demand in 10 of 12 such promotions filed during 1994 for which actual data were available, and the overall dollar value of the actual discounts paid out has exceeded projections by $233.9 million. The Commission's apparent concern regarding inflated demand projections is thus insufficient to justify a restriction on AT&T's index credit for promotional offerings.

The Commission's proposed limitation of promotional rates to an initial 90-day term likewise lacks a reasoned basis.[43] The Further Notice does not provide any rationale for the 90-day limit, which makes no sense in today's intensely competitive and constantly changing market. AT&T's interexchange competitors have no comparable constraint and routinely offer promotions that last far longer than 90 days, and sometimes extend over many years.[44] The new rules would deny AT&T the ability to meet such offers on their terms. This would not only

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[43] The proposal that AT&T base its demand forecasts on annualized, trued-up historical demand data is also ill-conceived and unnecessary. There is no record to support the imposition of new rules which require demand extrapolations from actual data and a burdensome true-up process. Moreover, the proposed quarterly "true-up" mechanism (see Further Notice, ¶ 56) is not adequate for its intended purpose; the limit on the number of times that headroom may be adjusted penalizes AT&T unfairly by denying timely use of the headroom. For example, if a new APP which is made a permanent offering experiences a slow initial growth rate, its index credit may be capped far below the actual level of discounts ultimately provided to customers. Limiting the number of true-ups also disregards the competitive reality that carriers must continually file new promotional offerings, which may grow at different rates, and that customers continually move from one offering to another.

[44] See, e.g., MCI Friends & Family Day Promotion, which is available for 23 months and provides free calling on any one day per year selected by the customer (MCI Tariff F.C.C. No. 1, 20th revised page 32.35); MCI Domestic Acquisition Promotion, which is available for 61 days and provides a 50% discount off domestic dial-1 calling every month for three months and then every third month for the next 21 months (MCI Tariff F.C.C. No. 1, 140th revised page No. 31); Sprint Sense Charter Promotion, which is available for 30 days and provides a lifetime waiver of the Sprint Sense monthly recurring charge (Sprint Tariff F.C.C. No. 1, 5th revised page 427.21).

unfairly impede AT&T's ability to compete, but would deny the public the types of promotions consumers want.

Indeed, the rules are poorly designed to accommodate some of the most common types of promotions offered in the marketplace today. For example, one common type of offering is a "loyalty" promotion, which might offer a customer one free month of service if the customer presubscribed to AT&T within 30 days and remained with AT&T for the next six months (i.e., pay for six months' service and get the seventh month free). The proposed rules would consider this an APP and limit its term to just 90 days. Under the proposed rules, the customer might not be allowed to order service during the 90-day term of the APP, but receive the benefit of the promotion well after the 90-day term (i.e. in the eighth month). Moreover, even assuming that AT&T were permitted after 90 days to file this promotion as a permanent offering (after which time it could begin to receive price cap credit), while the service would nominally be "permanent" under the rules, it would not continue to be useful because the ordering window would have closed during the initial 30 days, while the offering was still an APP.[45]

[45] It is also unclear what would happen to the "permanent" offering after the eighth month, when it was no longer of any practical use, because the proposed rules fail to specify any mechanism for withdrawal (or automatic expiration) of such "permanent" offerings after they no longer have any effect.

Finally, the Further Notice proposes to specify that new services will not be considered business offerings (and thus exempt from the price cap regulation described above) unless residential subscribers account for less than 5 percent of the projected demand. This proposal ignores the fact that, as shown above, there is no longer any viable distinction between the competitiveness of the residential and business segments of the interexchange market. Thus, it would be pointless for the Commission to specify some threshold of residential demand -- whether at 5 percent, or any other level -- as a "litmus test" for subjecting any of AT&T's offerings to price cap regulation.[46]

III. THE CONTINUED REASONABLENESS OF BASIC RATES CAN BEST BE ASSURED BY AN IMMEDIATE FINDING THAT AT&T IS NONDOMINANT, NOT BY THE IMPOSITION OF ADDITIONAL REGULATORY BURDENS THAT UNIQUELY DISADVANTAGE AT&T.

The Further Notice also seeks comment (¶¶ 58, 64-67) on whether the Commission should mandate a new

[46] The Commission's unnecessary proposal is also unworkable because it could result in back-door re-regulation of the many services the Commission has already correctly found to be subject to full competition, and which the Commission thus has determined should be provided on a streamlined basis, merely because there is some incidental usage by residential customers. Such incidental usage by residential subscribers is especially likely in view of the increasing trend towards "telecommuting" and other work-at-home options.

"basic rate index," replacing the existing residential index, in order to ensure that basic schedule increases do not threaten universal service or other Commission goals. The Commission's proposal is unnecessary and proceeds from the false premise that AT&T's basic MTS rates must be subject to special regulatory treatment to ensure that they remain reasonable because the market for interexchange services is not yet competitive.

The record before the Commission, however, shows conclusively that this is not so. To the contrary, as shown in Part I, supra, vigorous competition exists for all services in the interexchange market. These market forces will by themselves ensure that the Commission's universal service goals are achieved and that just, reasonable and non-discriminatory rates for residential customers are achieved. The Commission thus has no need to adopt a "basic rate index" or to otherwise constrain AT&T's ability to price its basic schedule services.[47]

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[47] The Commission's proposal to exclude from its index all discounted basic rate offerings, including those that are automatic and "non-self-selecting," is especially arbitrary. By excluding all discounted rates, including automatic, non-"self-selecting" discounts and promotions, the Commission would arbitrarily deprive AT&T of price cap credit for some of the most popular and beneficial discounts available to customers. For example, AT&T's "holiday rates," available on occasions such as July 4th, would be excluded even though they provide unqualified benefits to all AT&T customers. This change would protect no class of customers and would needlessly place further constraints on AT&T's ability to respond to the service offerings of its

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Additionally, the Commission seeks comment (Further Notice, ¶ 66) on the desirability of mandating adoption by AT&T of the "safety net" for low-volume and low-income customers previously proposed by AT&T in connection with its Reclassification Motion.[48] Standing alone, such a "safety net" rule applied only to AT&T is as unnecessary and unsupportable as the other proposals in the Further Notice. To underscore its confidence in market forces and its commitment to serving all customers, however, AT&T volunteered that safeguard as a transitional measure to be followed after reclassification as nondominant. Adopting the "safety net" proposal alone, and not in connection with a declaration of AT&T's nondominance, would only burden AT&T with yet another unique regulatory requirement, to the detriment of interexchange customers and full and unfettered interexchange competition.[49]

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competitors. In this regard, the proposed basic rate index is inferior even to the existing residential index, which the Commission has recognized is "obsolete" (Further Notice, ¶ 64).

48 See Letter from Alex Mandl, Executive Vice President, AT&T, to Reed E. Hundt, Chairman, FCC, dated October 4, 1994.

49 The Further Notice fails to explain why the Commission does not seek to extend such a requirement to all interexchange carriers, rather than to impose it on AT&T alone.

A. Basic MTS Rates Are, And Will Remain, Reasonable And Do Not Threaten Universal Service.

The overwhelming record summarized in Point I, supra, shows conclusively that the interexchange market is competitive and ensures that all rates for long distance service are, and remain, reasonable in all market segments. Any attempt by AT&T (or any other interexchange carrier) to raise rates to unreasonable levels would only drive customers to waiting competitors. These market pressures apply no less forcefully to AT&T's pricing of basic services than to its pricing of promotions and optional calling plans. Indeed, as the Commission has recognized, there is no reasoned basis on which to distinguish basic schedule MTS services from promotional or optional calling plan MTS offerings.[50] The Commission need not impose additional regulation to ensure the reasonableness of any of these rates.

The Commission's own statistics dispel any concern (Further Notice ¶ 63) that the availability of AT&T's promotional discounts to customers may be unduly restricted because equal access has not been implemented in some service areas. According to the Commission's own published data, more than 97 percent of all access lines nationwide have already been converted to equal access,

[50] Further Notice, ¶ 42

and independent LECs (who account for most of the remaining lines) have been converting their exchanges to equal access at a rapid pace.[51] Moreover, even in residual non-equal access areas customers generally have the ability to access AT&T's interexchange competitors through Feature Group A and/or B dialing protocols.[52] Thus, there is no justification for the Commission to conclude that AT&T's discount programs or alternatives to AT&T's basic service rates are "unavailable to a significant body of residential customers."[53] Moreover, if the Commission is concerned that lack of equal access might deprive some of these customers of discount programs, the appropriate solution is to require all LECs promptly to implement equal access, in order to extend all the benefits of interexchange competition to all interexchange customers.

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51 See "Telephone Lines and Offices Converted to Equal Access," Industry Analysis Division, Common Carrier Bureau (November 1994), Table 1 (showing 97.1 percent of total lines converted to equal access as of December, 1993). The Commission's study also indicates that, whereas only 70.6 percent of independent LECs' lines had been converted to equal access as of December 1990, the year-end figures for those companies increased to 77.5 percent, 84.5 percent, and 89.1 percent in 1991 through 1993, respectively. Id.

52 Ex Parte Presentation, p. 20 n.49.

53 Further Notice, ¶ 63.

Similarly unfounded is the Commission's concern (Further Notice, ¶ 61) that changes in basic MTS rates may increase denials of local service for non-payment of interexchange charges. First, most states prohibit some or all LECs from disconnecting local service for non-payment of interexchange charges.[54] The extent to which interexchange rates could, even at a theoretical level, affect the availability of local service would therefore appear to be significantly limited. Moreover, even the studies cited by the Commission provide no indication that the level of interexchange rates (as opposed to unrestrained interexchange usage by particular customers) is a significant cause of disconnection of local service.[55] Indeed, these same studies suggest that subscription to premium local services (e.g., call waiting, call answer, and unpublished numbers) is strongly correlated with disconnection of local service for non-payment.

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[54] At least eighteen states prohibit some or all Tier I LECs from disconnecting local service for non-payment of such charges. Additionally, forty-seven states prohibit Tier II or Tier III LECs from disconnecting local service for failure to pay long distance charges.

[55] The Commission cites to two reports, both commissioned by LECs: Field Research Corp., Affordability of Telephone Service, Vol. 1, Non-Customer Survey, for GTE/Pacific Bell (Oct. 1993); Chesapeake and Potomac Telephone Co.'s Submission of Telephone Penetration Studies, Formal Case No. 850 (D.C. Pub. Service Comm. Oct. 1993).

In all events, customers seeking to lower their overall telephone charges are almost universally free to take advantage of the calling plans and promotional offers of AT&T and its competitors. There is thus no basis to conclude that rates charged by AT&T and other interexchange carriers affect the availability of local service.

The Further Notice's additional suggestion (¶ 60) that AT&T's widespread promotional tariffs for Basket 1 services may somehow adversely affect achievement of the Commission's universal service objectives is likewise misplaced. In fact, the Commission's own published studies show that since the inception of incentive regulation of AT&T in mid-1989, telephone "penetration" has actually increased during the same time that AT&T has implemented numerous promotional discounts for Basket 1 services in response to intensifying competition in the interexchange market.[56] If anything, these facts show that promotional offers have expanded use

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[56] See "Telephone Subscribership in the United States," Industry Analysis Division, Common Carrier Bureau (April 1995), Table 1 (showing percentage of households with telephones increased from July 1989 to November 1994). Moreover, although the November 1994 penetration level declined by 0.4 percent from the percentage of households with telephones a year earlier, the Commission's study concludes that "[t]his decline is not statistically significant." Id., p. 3.

of the public network, an outcome that the Commission has identified as a primary regulatory goal.[57]

B. AT&T's Mass Market Discounts Do Not Implicate The Communications Act's Protection Against Unreasonable Discrimination.

The Further Notice also seeks comment on whether AT&T's promotional and optional calling plan discounted offerings implicate the Communications Act's protections against unreasonable discrimination. See 47 U.S.C. § 202(a); Further Notice, ¶¶ 58, 62. This issue has been resolved long ago, and should not be revived when, ironically, competition is even more intense and -- to AT&T's knowledge -- there has been no complaint that AT&T's offerings are discriminatory.

Because AT&T's mass market volume discounts reflect the intense competition for residential long distance customers and a legitimate balancing of prices with costs, the rate differences occasioned by those discounts are plainly reasonable.

For AT&T and, presumably, other long distance carriers, the average cost of serving "low volume" customers is significantly higher than the average cost of serving "high volume" customers. Such cost disparities are neither new nor unique to telecommunications,[58] and in

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[57] Further Notice, ¶ 60.

[58] See, e.g., ICC v. B&O R.R., 145 U.S. 263, 281-82 (1892) (noting the "universally accepted fact that a man may

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a competitive market they should and do produce rate differences through volume discounting. As the Commission has thus recognized, there has been "vigorous competition in optional calling plans" with rates "determined by market forces."[59]

Customers have benefited enormously from this competitive discounting, as the volume "threshold" to qualify for discounted rates has dropped lower and lower. Fully 60 percent of AT&T's consumer MTS calls, for example, are now discounted, generating total savings that exceed $1 billion annually.[60] Any policy that had the purpose or effect of discouraging such discounts would therefore be directly contrary to the public interest, and to the pro-competitive and pro-consumer objectives of the Communications Act.

It is therefore unsurprising that the Commission consistently and long ago rejected claims that mass market promotions and discounted offerings are unlawful. See, e.g., Private Line Rate Structure and Volume Discount

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buy, contract, or manufacture on a large scale cheaper proportionately than upon a small scale").

59 See Revisions to Price Cap Rules for AT&T, 8 FCC Rcd. 5205, 5208 (1993).

60 See also Policy and Rules Concerning Rates for Dominant Carriers, 8 FCC Rcd. at 3716 n.11 (the offering of promotions "benefits all ratepayers").

Practices, 97 F.C.C.2d 923 (1984); MCI v. AT&T, 104 F.C.C.2d 1383, 1394 n.29 (1986) ("flexible pricing options are beneficial to both consumers and carriers and should be encouraged as a proper response to competition").[61] These decisions reflect a recognition that cost differences and competitive conditions are the quintessential "neutral, rational bas[e]s underlying" rate differences, "which preclude[] a finding that the rates are 'unreasonably' discriminatory."[62]

The Further Notice also asks (¶ 62) for comments on just how closely cost differences must track price differences for volume discounts to be reasonable. To the extent this inquiry reflects a proposal on the part of the

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61 See also American Telephone & Telegraph Co. Revisions to Tariff F.C.C. No. 2 Wide Area Telecommunications Service (WATS), 4 FCC Rcd. 5389 (1989); AT&T Communications Revisions to Tariff F.C.C. No. 1 ("PRO America"), 60 R.R.2d 925 (1986).

62 AT&T v. FCC, 832 F.2d 1285, 1293 (D.C. Cir. 1987), quoting National Ass'n of Regulatory Util. Comm'rs. v. FCC, 737 F.2d 1095, 1140 (D.C. Cir. 1984); see also Harborlite v. ICC, 613 F.2d 1088, 1100 (D.C. Cir. 1979) quoting U.S. v. Illinois Central R.R., 263 U.S. 515, 524 (1924) (rate "disparity is not unlawful if it is justified by the cost of the respective services"); Dresser Indus., Inc. v. ICC, 714 F.2d 588, 601 (5th Cir. 1983) ("competitive . . . conditions are a legitimate basis for a disparity in . . . rates"); Sea-Land Serv. v. ICC, 738 F.2d 1311, 1317 (D.C. Cir. 1984) ("[t]he core concern in the nondiscrimination area has been to maintain equality of pricing for shipments subject to substantially similar costs and competitive conditions, while permitting carriers to introduce differential pricing where dissimilarities in those key variables exist").

Commission to scrutinize "detailed cost justifications" for volume discounts, it is clearly misplaced.[63] In addition to seriously undermining the pricing flexibility that is the foundation of price cap regulation, burdensome cost review is wholly unwarranted. Structural considerations ensure that only price differences that are cost justified will be sustainable in the market.

Foremost, the residential market is vigorously competitive, and in a competitive market no carrier can engage in unreasonable discrimination. Moreover, the absence of barriers to resale -- and the large number of active resellers, including resellers who offer even the smallest residential customers the ability to bypass their presubscribed carrier on a call-by-call basis simply by dialing an access code -- ensure that any attempt to price discriminate would be defeated through arbitrage.[64]

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63 Cf. Private Line Rate Structure and Volume Discount Practices, supra, 97 F.C.C.2d at 944 ("[i]t is easier and more beneficial to the public interest for the Commission to limit discrimination by inspecting a carrier's rate structure than by delving into a carrier's detailed cost justification").

64 See, e.g., American Telephone and Telegraph Co., supra, 4 FCC Rcd. at 5391 ("Effective price discrimination requires some barriers to arbitrage. If a service can be resold freely, then price discrimination is limited to the transaction costs of resale"); Boise Cascade Corp. v. FTC, 837 F.2d 1127, 1149 (D.C. Cir. 1988) (Williams, J., concurring) ("[I]t is black letter economics that price discrimination cannot occur if the favored customers can resell to the disfavored").

Further, where the discounted rates are reasonably accessible to all customers, both the Commission and the courts have recognized that there can be no serious risk of unreasonable discrimination.[65] Discounts in the long distance industry are advertised in the mass media and broadly available, and any customer can obtain them by purchasing modest quantities of service. AT&T's "True" programs, for example, are open to all customers, offer discounts at no fee for any month in which a customer's bill exceeds $10, and to date have attracted more than 18 million subscribers. This $10 threshold is accessible to all customers -- indeed, approximately two-thirds of AT&T's customers pass that threshold in at least one month in the course of a year.[66]

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65 See, e.g., AT&T Communications (Tariff 1), 70 R.R.2d 1272, 1277 (1992) (rate disparity not unreasonable "because customer choice, rather than a carrier-imposed barrier, controls the availability of the discounted rate"); Sea-Land Serv. v. ICC, supra, 738 F.2d at 1317 (discounted rates "can still be accommodated to the principle of nondiscrimination by requiring a carrier offering such rates to make them available to any shipper willing and able to meet the contract's terms").

66 Where a discount is broadly available, the fact that some customers' preferences for making relatively few long-distance calls will render them ineligible does not render those discounts unlawful. See AT&T Communications (Tariff 1), supra, 70 R.R.2d at 1277 (discount not unreasonably discriminatory because, although customer preferences might lead some customers not to take advantage of it, there were "no qualifying criteria to unreasonably limit" customer choice). For similar reasons, those customers whose usage patterns render them eligible for discount programs but who

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Finally, were the Commission actually to engage in a comparative cost review, that review would demonstrate that, far from being disadvantaged relative to high-volume customers, those low-volume customers whose usage renders them ineligible for discounts are the beneficiaries, not the victims, of price differences. AT&T's margins are significantly lower for low-volume (i.e., below $10 per month) customers than high-volume customers (i.e., above $10 per month), because price cap treatment of access costs and other regulatory actions have artificially reduced rates for those low-volume customers below competitive levels. Indeed, for many of these low-volume customers, basic schedule rates do not even cover AT&T's costs.[67] Thus, to the extent that rate

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nevertheless choose not to participate in such programs cannot conceivably be the victims of unreasonable discrimination. See, e.g., Shreve Equip., Inc. v. Clay Equip. Corp., 650 F.2d 101, 105 (6th Cir. 1981) ("where a purchaser does not take advantage of a lower price or a discount which is functionally available on an equal basis, it has been held that either no price discrimination has occurred, or the discrimination is not the proximate cause of the injury"); Boise Cascade Corp. v. FTC, supra, 837 F.2d at 1130 (same).

67 See Peter K. Pitsch, A Brief History of Competition in the Long Distance Communications Market, at 17, attached to Letter from Charles L. Ward, Government Affairs Director, AT&T, to Chief Economist, Office of Plans & Policy, Federal Communications Commission, submitted in CC Docket 79-252 (Sept. 22, 1994) (basic rates do not cover the costs of serving the one-third of consumers that make under $3 a month in calls); id. (noting that in any given month, roughly 10 million of

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differences are not cost justified, it is low-volume customers who are favored and there can be no claim that they are the victims of unreasonable discrimination.[68]

This benefit to low-volume customers paying basic rates, however, is a result of regulation-induced distortions in pricing that serve no discernible public purpose. Low-volume customers require no special governmental protection. They have, and exercise, the same freedom of choice among carriers as other customers. Indeed, AT&T residential customers with less than $10 in average monthly usage changed carriers more than 10 million times in 1994 alone (representing more than 40 percent of all such switches).[69] Moreover, the residential consumer market is largely homogenous across

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AT&T's customers make no calls at all and thus make no contribution to fixed costs); id. at 18 (customer who purchases between $3 and $10 of long distance service contributes only one-third as much to fixed costs as an average customer); id. at 38 (the half of AT&T's dial-1 customers that spend more than $10/month generate nearly 90% of the revenues).

68 The fact that a particular customer may be a low-volume customer one month and a high volume customer the next (see Further Notice, ¶ 62) does not alter this analysis. In any given month, approximately 26 percent of AT&T's customers make less than $3 in long-distance calls and do not cover their costs for that month. The fact that these are not the same customers each month is irrelevant.

69 See Letter from Charles L. Ward, AT&T, to Acting Secretary, FCC (April 20, 1994).

volume differences, so there is no discernible correlation between volume and income, age, race, or geographic location.[70] All that distinguishes low-volume customers from high-volume customers is that the former make fewer calls.

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[70] Id.

CONCLUSION

For the reasons stated above, the Commission should recognize that continued price cap regulation of Basket 1 service is no longer necessary or appropriate in light of the overwhelming record evidence that the interexchange market is now fully competitive. Adopting even more restrictive regulation of AT&T's pricing flexibility, as the Commission proposes here, is all the more unjustified against this background. Accordingly, the Commission should not adopt the rules proposed in the Further Notice.

Respectfully submitted,

AT&T CORP.

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July 3, 1995

STATEMENT

OF

ROBERT D. WILLIG

Background

My name is Robert Willig. I hold the position of Professor of Economics and Public Affairs at Princeton University, where I teach in the Economics Department and lead the economics program at the Woodrow Wilson School of Public and International Affairs. My fields of academic specialization are industrial organization and government policy towards business. I took academic leave to serve as Deputy Assistant Attorney General in the Antitrust Division of the U.S. Department of Justice from 1989 to 1991.

I have served as an expert witness before Congress, Federal administrative agencies, and state Public Utility Commissions on subjects involving regulation and deregulation of communications, transportation, energy and other industries. I have also provided expert testimony before state and Federal Courts and agencies on antitrust matters. I am an elected Fellow of the Econometric Society, a former member of the Research Advisory Council of the American Enterprise Institute, an Associate of the Center for International Studies, a former Member of the New Jersey Governor's Task Force on the Market Pricing of Electricity, and a Director of Consultants in Industry Economics, L.L.C.

Introduction

I have been asked by AT&T to respond to some of the key issues raised by the FCC's May 5, 1995, "Further Notice of Proposed Rulemaking" (Further Notice). At its most general level, the Further Notice seeks comments on the regulatory treatment of all AT&T's Basket 1 services. More specifically, comments are sought on the price cap regulation of promotional tariffs and optional calling plans.

The Further Notice recognizes (para. 3) that price cap regulation is designed to mirror the efficiency incentives found in competitive markets and to function as a transitional regulatory mechanism until market competition makes it unnecessary. This recognition by the Commission is consistent with economics, which holds as a basic tenet that where effective competition reigns, market outcomes accomplish the appropriate goals of regulation. Consequently, in such markets, the Commission should accord business freedom from regulation because the outcome will predictably serve the public interest, without the inevitable costs to society of the influence and process of even the best of regulation.

As I demonstrated in an earlier submission to the Commission (Willig/Bernheim Affidavit, "An Analysis of the MFJ Line of Business Restrictions," December 1, 1994), the facts, economic logic, and the Commission's own findings all clearly indicate that AT&T's Basket 1 services have no significant market power and are subject to effective competition. Thus, the most important response to the broadest of the Commission's inquiries is the easiest to state: The Commission should eliminate regulation of AT&T's interexchange services. This move is overdue, and would make any consideration of the details of price cap regulation of Basket 1 services entirely moot.

Nevertheless, inasmuch as the Further Notice proceeds to propose significant changes to the price cap regulatory mechanism that applies to AT&T's interexchange offerings, I shall proceed to respond with economic analyses that are separate from reiteration of the primary point that extant effective competition makes any regulation unnecessary and only counterproductive. As a matter of background, and as described in Section 1 below, the Commission proposes to collect self-selecting promotions and optional calling plans (OCPs) under a new heading called alternative pricing plans (APPs), and to combine day, evening, and night/weekend services and APPs into a single consolidated service category.

In contrast to such consolidation, the Commission proposes to regulate a new basic rate index for just the residential services of AT&T that are undiscounted. This regulation would take no account of any discounted offerings, and would have the effect of repressing AT&T's market incentives and ability to offer APPs to consumers. This result is evidently intended by the Commission, under the belief that the reduction in the use of APPs will stimulate a preferable form of competition that focusses more on basic long distance rates.[1] In Section 2, below, I show how misguided is the Commission's belief that concerns about discrimination warrant a regulatory preference for competition through basic rates. In essence, there is no discriminatory dimension of concern to the groups of consumers who use the APPs.

In Section 3, I show that the Commission's proposed regulations for including APPs in price caps that differ from the existing rules for promotions tend systematically to undercount the APPS' benefits to consumers. Most dramatically, for example, the proposals would give no price cap credit at all for a self-selected promotional discount that lasted for less than 90 days. The Commission's stated concerns about the difficulties of projecting APP utilization are readily overcome, and are clearly insufficient rationale for the resulting repression of APPs that benefit consumers.

In Section 4, I show that the flexibility of APPs provides for greater consumer and social welfare than does competition that is channeled by regulation solely through basic rates. A price-caps regulatory mechanism that truly mirrored the workings of competition would neither single out APPs for disfavored treatment, nor impose a separate cap constraint on basic rates. Rather, it would accord equivalent treatment to all forms of pricing, based on revenue or volume weights (projected or historical, as available), and thereby provide incentives to the regulated firm to offer a rate structure and a spectrum of promotional and discount prices that maximize consumer benefits, given the returns permitted the firm by the level of its cap-constraint. Thus, not only are the Commission's concerns about APPs misplaced, but harm to consumers would predictably follow from the Commission's proposals that show a preference for basic rates and discrimination against APPs.

1. Proposed Service Consolidation

AT&T offers different forms of discounts to its customers. Optional Calling Plans (OCPs) are supplemental MTS offerings usually designed to attract high volume customers.

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[1] *Further NPRM*, paragraphs 24 and 32.

They require a time or financial commitment on the part of the customer.[2] Promotions typically involve a discount from existing rates, for a limited amount of time, to some sub-class of users. Promotions may apply automatically or may require selection by the customer.[3]

The Commission proposes combining OCPs and self-selecting promotions under a new heading called alternative pricing plans (APPs). The Commission's stated logic is that these service categories are very much alike in that they all offer discounted alternatives to basic AT&T rates. As noted, OCPs and promotions are currently treated differently even though they may essentially be the same.[4] Combining the two categories will ensure that both programs will be accorded equivalent regulatory treatment.[5] Also, separate sets of rules will not be needed for both promotions and OCPs.

Within the group of Basket 1 services, the Commission has proposed combining service categories for day, evening, and night/weekend MTS with APPs. Service categories are designed to place price caps on finer partitions of the set of offerings within the basket system. The consolidation of service categories is suggested because of the "...evidence of cross-elasticity of demand between the non-discounted domestic MTS basic schedule offerings and the services ... defined above as APPs..."[6] According to the Commission, putting caps on service categories within the basket gives flexibility to AT&T for allocating costs and pricing efficiently, while protecting customers from rate increases and subsidization of dissimilar services.[7]

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[2]*Further NPRM*, paragraphs 21-22.

[3]Examples include the discount on calls from Hawaii described in footnote 37 of the *Further NPRM* and programs such as True USA, respectively.

[4]*Further NPRM*, paragraph 48.

[5]However, under the Commission's proposals, that equivalent treatment would be disfavored relative to basic rates.

[6]*Further NPRM*, paragraph 42.

[7]*Further NPRM*, paragraph 6.